

STATE GROUP INSURANCE PROGRAM

2004 Annual Program and Financial Report





STATE OF TENNESSEE
DEPARTMENT OF FINANCE AND ADMINISTRATION
INSURANCE ADMINISTRATION
1300 William R. Snodgrass Tennessee Tower
312 Eighth Avenue North
Nashville, TN 37243

June 30, 2005

Ladies and Gentlemen:

We are pleased to submit the 2004 Annual Program and Financial Report of the Division of Insurance Administration. This unit of the Department of Finance and Administration manages insurance benefits for over 135,000 employees of and over 22,000 Medicare eligible retirees from public sector organizations in Tennessee. At the end of 2004, the state-sponsored plans provided health insurance coverage to over 261,000 individuals.

The data presented here demonstrates trends from program, statistical and financial standpoints. The financial statements reflect the fiscal year ended June 30, 2004.

Calendar year 2004 was a period of some significant developments for the division and the insurance programs sponsored by the State of Tennessee. These developments include:

- Benefit payments for medical treatment by the State, Local Education and Local Government Plans exceeded \$835 million during 2004
- The rate of increase in benefit costs for 2004 was down substantially when compared to the prior four years
- The state-sponsored insurance plans rebalanced the sharing of medical costs between the plans and plan participants through changes in benefit levels for the PPO, POS and HMO options
- The health coverage was modified to add mail order pharmacy opportunities that permitted plan participants to purchase extended duration prescriptions at lower copayments
- For the second year in a row, revenues exceeded expenditures for healthcare coverage for each of the state-sponsored plans
- All three plans experienced improved financial status due to these gains; the State and Local Education Plans were fully reserved at year end
- The division initiated major steps to ensure compliance with new security and privacy requirements related to personal health information
- For the first time in many years, the financial and compliance audits of the State, Local Education, Local Government and Medicare Supplement insurance funds contained no findings. The examinations were conducted by the Division of State Audit

It is our intent to demonstrate through this report our continuing commitment to

- Provide affordable, quality benefits to public sector employees and retirees
- Expand the use of electronic communication
- Improve computer systems to provide for the effective recording of eligibility and accounting activity
- Sponsor managed care health plans with accessible and consistent provider networks
- Conduct effective assessments of trends in healthcare utilization and benefit costs
- Effectively respond to changes in state and federal laws and regulations
- Hold our contract partners accountable for their performance

- Promote managed efforts to improve lifestyles
- Support other public sector activities intended to improve the delivery or financing of healthcare
- Demonstrate value to plan participants when they compare benefit payments with employer and employee contributions
- Be good stewards of public sector funds

While the State Group Insurance Program sponsors the coverages and programs reviewed in this report, we work in partnership with 11 contractors and a number of other state agencies to deliver services to program participants. The results reported here reflect their contribution, as well.

Sincerely,

A handwritten signature in cursive script, appearing to read "Richard Chapman".

Richard Chapman, Director

A handwritten signature in cursive script, appearing to read "M. D. Goetz Jr.".

M. D. Goetz Jr., Commissioner



INTRODUCTION [5]

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Tennessee Department of Finance and Administration. Authorization Number 317238, 1,000 copies, June 2005.
This public document was promulgated at a cost of \$2.54 per copy.

The Division of Insurance Administration operates within the State of Tennessee's Department of Finance and Administration. A committed staff of 38 works to administer health, dental, life and long-term care insurance coverages for over 261,000 public sector employees, retirees and their covered dependents.

In addition to insurance coverages, the division also administers an Employee Assistance Program and a State Employee Wellness Program. These related programs complement insurance programs by educating employees and their families about prevention and behaviors that can affect their physical and mental health.

State Group Insurance Program participants include state government and higher education employees, as well as employees of local school systems and local government agencies who elect to participate in one of the state-sponsored plans. Various quasi-governmental and nonprofit agencies receiving state support may also elect to participate in the Local Government Plan.

Currently, the Preferred Provider Organization (PPO), administered through BlueCross BlueShield of Tennessee, is available statewide to all participants.

A Point of Service (POS) option is also available statewide. POS offerings in 2004 included: BlueCross BlueShield—West and Middle and John Deere Health—East.

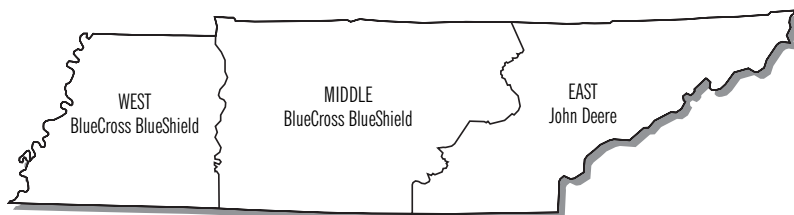
Health Maintenance Organizations (HMOs) are offered in 60 of Tennessee's 95 counties. HMO offerings in 2004 were: Aetna Memphis, Aetna Nashville, John Deere Health Chattanooga, John Deere Health Knoxville and John Deere Health Tri-Cities.

In addition to health insurance, optional dental coverage, underwritten and administered by Assurant Employee Benefits, is available to participants in all three plans. State employees are provided basic term and accidental death and dismemberment through Fort Dearborn Life while the optional term and universal life coverages are underwritten by UnumProvident Life and Accident. Long-term care insurance is available to state employees, retirees and eligible family members through MedAmerica Insurance Company.

Enrollment Highlights

Total Group Health Lives	261,378
Employees:	
State PPO	31,513
State POSs	19,444
State HMOs	21,991
Local Education PPO	25,702
Local Education POSs	16,328
Local Education HMOs	5,290
Local Government PPO	5,397
Local Government POSs	5,686
Local Government HMOs	4,305
Local Government PPO Limited	180
Total Employee Group Health	135,836
Optional Dental Coverage	36,436
Optional Life Insurance Products	66,237
Optional Long-Term Care Coverage	2,483
Retiree Medicare Supplement	22,733

Point of Service (POS) Service Area



Health Maintenance Organization (HMO) Service Area



The authorization for providing group insurance benefits for public officers, state, local education and local government employees and retirees is found in Chapter 27 of Title 8, Tennessee Code Annotated.

The benefit plans authorized by this legislation are governed separately by three committees identified as the State, Local Education and Local Government Insurance Committees. Each of these committees represents the interests of the employer(s) and their employees and retirees in financially separate benefit plans.

The responsibilities of each committee can be summarized under four broad areas:

- 1) To establish the benefit plans offered.
- 2) To approve premiums necessary to fund plan operations.
- 3) To provide for the administration of certain plan functions through the selection of contractors and monitoring of vendor performance.
- 4) To establish and review policy related to eligibility, benefits and appeals.

Committee Members

M. D. Goetz Jr., Chairman — S, E, G
Commissioner, Department of Finance and Administration

John G. Morgan — S, E, G
Comptroller of the Treasury

Dale Sims — S, E, G
State Treasurer

Paula Flowers — S, E
Commissioner, Department of Commerce and Insurance

Jeannie Bellephant — S
Employee Representative

Debbie Johnson — S
Higher Education Representative

Nat Johnson — S
Designee, Department of Personnel

Linda McCarty — S
Tennessee State Employee Association

Tom Spillman — S
Employee Representative

Donna Barber — E
Middle Tennessee Teacher Representative

Jim Jones — E
Designee, Department of Education

Clark Justis — E
East Tennessee Teacher Representative

Josephine King — E
West Tennessee Teacher Representative

Phillip White — E
Tennessee School Boards Association

Randy Williams — G
Tennessee Municipal League

Bob Wormsley — G
Tennessee County Services Association

S — State Insurance Committee
E — Local Education Insurance Committee
G — Local Government Insurance Committee

BlueCross BlueShield of Tennessee

Providing for administration of healthcare coverage for plan members in the Preferred Provider Organization (PPO), Point of Service (POS) Middle and West and retiree Medicare Supplement Programs.

John Deere Health

Providing for administration of healthcare coverage for plan members in the Point of Service (POS) East and Health Maintenance Organization (HMO) East.

Aetna

Providing for administration of healthcare coverage for plan members in the Health Maintenance Organization (HMO) Memphis and Nashville.

Fort Dearborn Life Insurance Company

Providing basic term and accidental death and dismemberment insurance for state plan members enrolled in a healthcare option.

UnumProvident Life and Accident Insurance Company

Providing optional term and universal life insurance to state plan members who choose to enroll in this coverage.

Assurant Employee Benefits

Providing dental insurance to participating plan members statewide.

United Behavioral Health

Providing employee assistance program (EAP) services to all plan members and administration of mental health and substance abuse coverage for plan members in the Preferred Provider Organization (PPO) and Point of Service (POS) healthcare options.

MedAmerica Insurance Company

Providing long-term care coverage to state plan members and their eligible family members who choose to enroll in this coverage.

Harris Health Trends

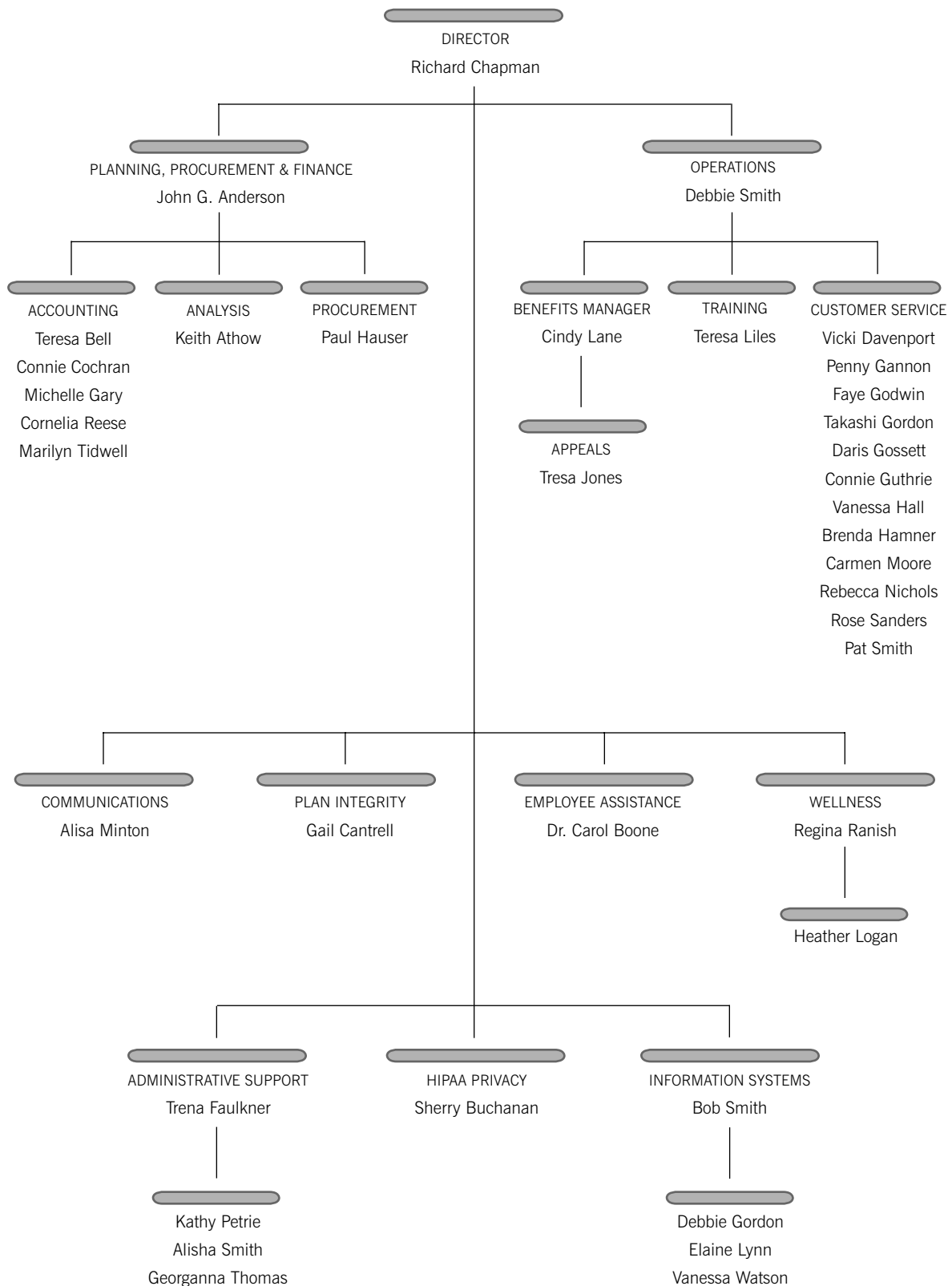
Providing support for wellness program services for central state plan members enrolled in a healthcare option.

The Medstat Group

Providing analytical services to assess healthcare utilization and claims-based cost for our population.

Mellon Human Resources and Investor Services

Providing benefits and administrative consultant services to the division.



The appeals process established by the Insurance Committees received 479 requests for a benefits review; 85 were resolved by the division appeals coordinator without the need for a formal written appeal. The remaining 394 filed a formal written appeal with 184 cases resolved during initial review between the division and the claims administrator. Of the 135 cases reviewed by the Staff Appeals Committee, 55 were approved, 67 denied and 13 deferred. The remaining 75 cases were still pending decisions at the end of the year.

The division acted on 56 requests for a waiver of premium due to disability with 50 requests approved and 6 denied.

During 2004, premium quotes were requested from 71 agencies interested in joining the Local Government Plan. Of those, 18 agencies joined the plan.

A total of 855 individuals applied for coverage through the medical underwriting or proof of insurability process. Of those, 292 were approved and authorized to enroll in coverage.

The division's eligibility team reviewed 35 cases. Of these, 24 were approved and 11 denied.

Twelve insurance preparer training classes and 11 annual transfer meetings were held across the state.

The division continues to expand the information provided on our web site to allow participants ease of access to information, forms and publications. Over 190,000 publications and forms were downloaded from the site during the year.

The division conducts EAP and Wellness training sessions across the state and encourages electronic registration for individuals with internet access. Over 4,000 individuals registered for a seminar on-line.

The division conducted a promotional campaign to encourage use of automated clearing house for payment of premium for individuals on direct pay. This effort resulted in approximately 200 individuals signing up for ACH payment.

Monitoring of contractor performance resulted in total noncompliance penalties assessed of \$124,000 from plan administrators and insurance companies under contract with the Insurance Committees.

The integrity section initiated quarterly data matches with vital records information to identify instances where certain types of dependents no longer qualified for coverage. Similar reviews were conducted with employment information maintained by the Department of Labor and Workforce Development.

Through a competitive procurement process, John Deere Health was selected for the continued provision of HMO coverage for individuals in the eastern part of the state and Delta Dental was selected as the new provider for the Preferred Dental Organization statewide. The contracts were effective at the beginning of 2005.

During 2004, the division took steps to "carve out" the mental health and substance abuse benefits incorporated into the health contracts to allow for one provider for all participants for mental health, substance abuse, and employee assistance program services. Through a competitive procurement process, Magellan Health Services was selected as the provider. A substantial amount of staff time was devoted to communication for transition for individuals currently in treatment.

At the beginning of 2004, the division implemented significant changes to the pharmacy benefit available through the PPO, POS and HMO options, adopting a three-tier copayment structure. A home delivery option also became available for prescriptions with extended duration. After implementation, the home delivery network was expanded to include several pharmacy chains and independent pharmacies to accommodate those individuals who did not wish to order medications via mail.

Through distribution of "excess premium" in Medicare supplement coverage, plan members were provided a return of \$10 per month to offset the monthly premium. This distribution will continue during 2005 at a rate of \$20 per month.

Nearly 1,800 employees completed the six-month Peel the Pounds weight loss challenge and collectively lost a total of 4.75 tons.

The Employee Assistance Program increased its employee utilization in the area of direct counseling services to 5.5 percent. Additionally, the number of training activities reached a record number of 6,062 employees, an increase from 1,078 in 2003.

The Employee Assistance Program participated in the Harvard School and Workplace Study. Approximately 7,000 employees volunteered to be involved in the study. Results revealed that obesity and depression were among the most frequent problems of the workforce. Depression was the leading condition affecting absenteeism, presenteeism and critical incidents. Obesity was the least major problem being treated.

The division provided significant levels of support to efforts to reform the TennCare Program and assisted with procurements conducted by the Comptroller's Research Office and the Treasurer's Investment Division.

During 2005, a number of contracts will either be extended or the services will be continued as a result of a competitive procurement process. These include: BlueCross BlueShield PPO administrative services statewide; Harris Health Trends for support for wellness services; and Mellon Human Resources for benefit and administrative consulting services.

Several contracts will expire at the end of 2005 and the division will issue Requests for Proposals to re-procure these services. These include: optional prepaid dental coverage; administration of Health Maintenance Organization benefits in the Nashville and Memphis service areas; administration of Point of Service benefits in the west, middle and east service areas; optional term and universal life coverages; and administration of Medicare Supplement benefits.

The division, in partnership with the Division of Accounts, will conduct an assessment of the cost of other post employment benefits required under new Government Accounting Standards Board rules.

The integrity section will conduct an audit of documentation supporting the continued eligibility for benefits by certain classes of dependents.

Communication project for the upcoming year include the distribution of updated insurance handbooks to all plan members enrolled in coverage.

The Employee Assistance Program will continue to enhance the quality and access to EAP services, striving to increase the average yearly utilization rate of 5 percent for direct counseling contacts with the new provider.

The Employee Assistance Program will utilize the self-screening services available through the new provider, Magellan Health Services, which address employee problems affecting the workplace including alcohol, anxiety, depression, eating disorders and stress.

The second round of Peel the Pounds program activity is expected to surpass the 2004 results.

The division will continue to examine the new federal "Medicare Prescription Drug Improvement and Modernization Act of 2003" in particular the new pharmacy benefits under Medicare Part D and their impact on benefits provided to eligible Medicare retirees. Any necessary benefit changes resulting from this new law will be considered by the insurance committees.

The state will begin efforts to procure and implement new management software, called an Enterprise Resource Plan, which represents a significant opportunity to upgrade the division's 15 year old eligibility, enrollment and premium collection software.

State employees, University of Tennessee and Board of Regents employees comprise the State Plan. This plan provided coverage for 72,948 active employees, COBRA participants and qualified retirees.

For 2004, the portion of plan members selecting the POS option continued to increase, growing from 16,132 to 19,444. HMO selection declined from 22,332 to 21,991 and PPO participation declined from 33,766 to 31,513.

Employees may choose to participate in optional dental insurance. One prepaid dental plan and one preferred provider dental plan were available. State employees electing dental coverage totaled 29,655 at year end, an increase of 1,036 during the calendar year.

During 2004, Fort Dearborn received over \$8.9 million in premium for the basic term life and the accidental death and dismemberment coverages. Expenses reported for 2004 included \$6.5 million in basic term and accidental death and dismemberment claims and \$336,492 in optional accidental death and dismemberment claims. Administrative fees were \$60,000, reserving requirements were \$1.9 million, conversion expenses were \$69,000 and taxes were \$144,000.

Employee term life benefits exceeded \$5.3 million and were paid on behalf of 143 employees who died during 2004. An additional \$900,000 in employee accidental death and dismemberment benefits were provided by the plan. Employees received \$393,017 in benefit payments due to the death of a covered dependent and \$242,446 due to an accident involving the death or dismemberment of a dependent.

At 2004 year end, 13,278 employees were covered under the optional term life insurance plan, in addition to 6,047 spouses and 7,066 children. The coverage for employees exceeded \$960 million, spouse coverage was just under \$125 million and the child term rider amount was \$27.7 million. Premiums for 2004 were \$4.7 million, while claims totaled \$3.5 million.

The optional universal life covered 7,252 employees and 1,371 spouses who maintained over \$337 million in coverage. About

\$2.87 million of the annual premium paid for the life benefit with annual claims of \$2.8 million. At the end of December, the employee cash value had grown to more than \$64 million.

Benefit payments by the State Plan continued to increase for the sixth year in a row. For the PPO option, total allowed amounts per capita increased by 12.7 percent to \$4,885 for 2004. Inpatient benefits increased by 10.7 percent while outpatient costs grew by 13.4 percent. Despite a slight decrease in the number of days per 1,000 and admissions per 1,000, overall inpatient costs were driven up mainly due to an increase in the allowed amount per day.

Total allowed amounts per capita for the POS increased by 4 percent to \$3,267 for 2004. Inpatient payments decreased by 1.5 percent due to a combination of decreased utilization and flat payments per inpatient day. Payments for outpatient services increased by 5.6 percent.

For the PPO, pharmacy plan benefit payments were \$1,114 per capita — a 9.8 percent increase over 2003. For the POS, plan payments were \$644 per capita — a 4.5 percent decrease over 2003.

The State Plan paid 84 percent of the eligible PPO expenses and 89 percent of the POS eligible expenses during 2004, while the remaining 16 and 11 percent, respectively, were paid by the plan member. The benefits paid by the HMO were 91 percent of eligible expenses — about the same as 2003.

The increasing price and utilization of medical services (outpatient care) and prescription drugs will continue to have impact on the future increase in plan benefits. Demographic changes including the aging of the active workforce and the growth in the number of retirees will also place demands on the future growth of plan costs.

The state continues to monitor its plan benefits each year, with the goal of providing maximum value to plan members while sharing benefit expenses appropriately.

Health Contracts

Preferred Provider Organization (PPO)

BlueCross BlueShield	31,513
Percent of Total	43.2%

Health Maintenance Organization (HMO)

Aetna Nashville	7,827
Percent of Total	10.7%
Aetna Memphis	4,452
Percent of Total	6.1%
John Deere Health Knoxville	5,096
Percent of Total	7.0%
John Deere Health Chattanooga	2,267
Percent of Total	3.1%
John Deere Health Tri-Cities	2,349
Percent of Total	3.2%

Point of Service (POS)

West — BlueCross BlueShield	5,736
Percent of Total	7.9%
Middle — BlueCross BlueShield	10,133
Percent of Total	13.9%
East — John Deere Health	3,575
Percent of Total	4.9%

Optional Insurance Contracts

DEC. 31, 2004 DEC. 31, 2003

Dental Insurance

Prepaid Plan	21,030	21,045
Preferred Provider Plan	8,625	7,574
Total Dental	29,655	28,619

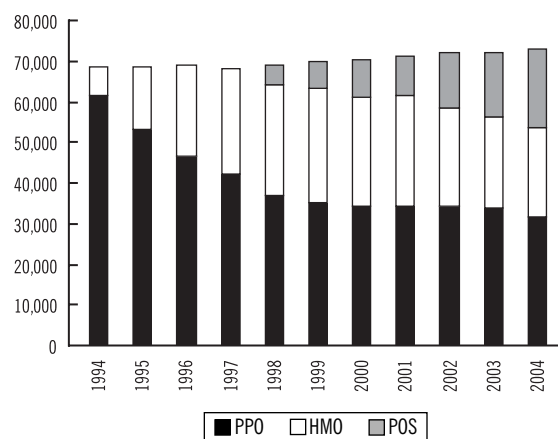
Optional Life Coverages

Term Life	26,391	25,908
Universal Life	8,623	8,754
Special Accident	30,429	30,581
Perma Plan	794	902
Total Life	66,237	66,145

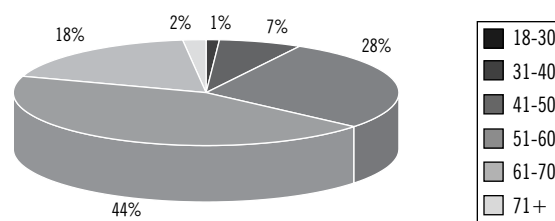
Long-Term Care Insurance

Employees	1,898	2,098
Retirees	79	78
Eligible Family Members	506	537
Total Long-Term Care	2,483	2,713

Total Contracts by Healthcare Option

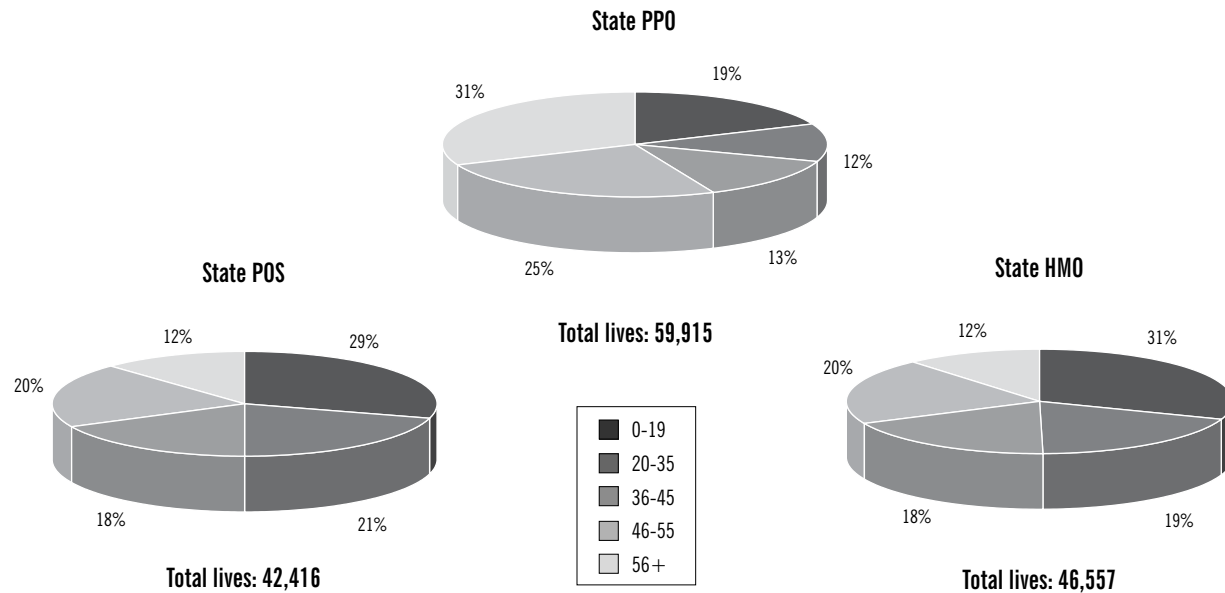


Long-Term Care Enrollment by Age



Long-Term Care Enrollment by Gender



Health Enrollment Demographics**Chronic Conditions—Patients and Medical Costs**

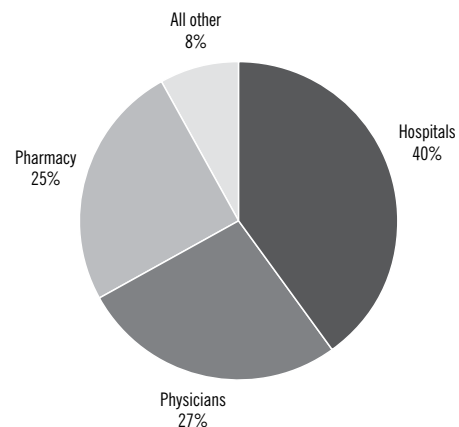
	TOTAL PATIENTS	TOTAL COSTS
Hypertension	24,733	\$ 4,520,930
Diabetes	10,131	\$ 4,748,646
Osteoarthritis	8,991	\$ 11,125,253
Mental Health—Depression	6,362	\$ 2,132,319
Coronary Artery Disease	5,122	\$ 21,976,793
Asthma	4,476	\$ 1,373,111
Mental Health—Anxiety Disorder	2,364	\$ 297,087
Obstructive Pulmonary Disease	2,308	\$ 1,544,325
Congestive Heart Failure	1,029	\$ 3,156,646
Mental Health—Bipolar Disease	1,025	\$ 697,579
Rheumatoid Arthritis	808	\$ 1,327,980
HIV Infection	153	\$ 165,686

Medical costs represent the amount paid by the plan for facility and professional services provided under medical coverage (excluding prescription drugs). Data represents 2004 paid claims.

Benefits Distribution by Provider Type (Paid Claims)

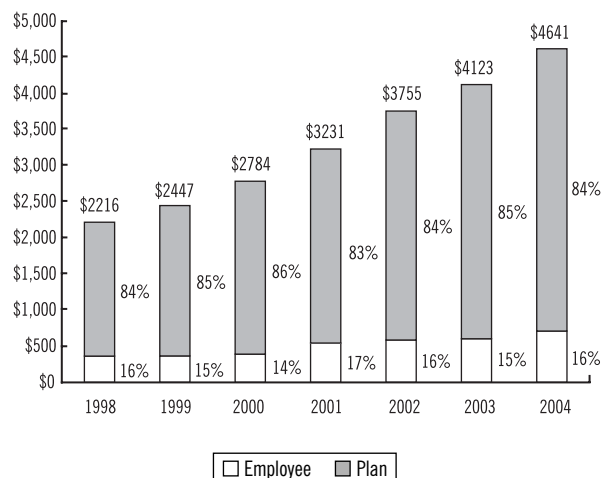
PPO, POS and HMO Total Disbursements: \$475,389,176 (amount reflects all health vendors submitting data for 2004)

Total self-insured paid claims for 2004 increased from \$445,619,543 in 2003. As a percent of the total, payments to physicians were basically flat when compared to 2003, while there was a slight increase in payments to hospitals and a slight decrease in payments to pharmacies.



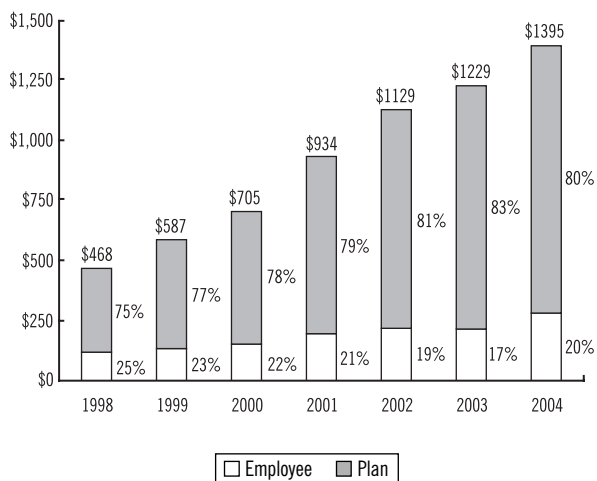
PPO Per Capita Payments

Employee portion represents deductibles and coinsurance/copays. Percentages indicate portion of medical expenses paid by employee or plan.



PPO Per Capita Drug Payments

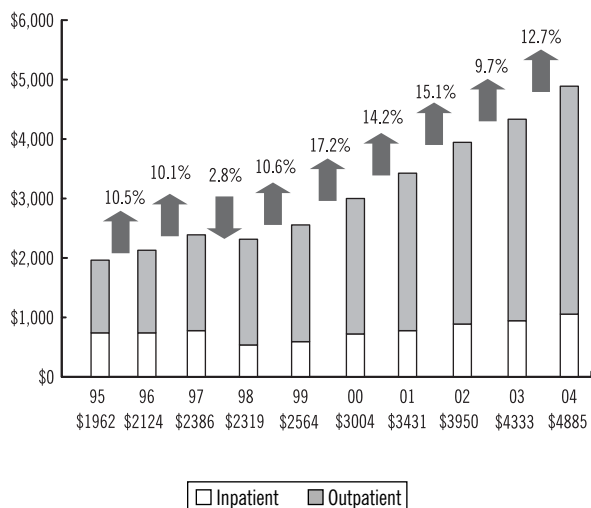
Percentages indicate portion of pharmacy expense paid by the employee and the plan.



PPO Total Payments Per Capita

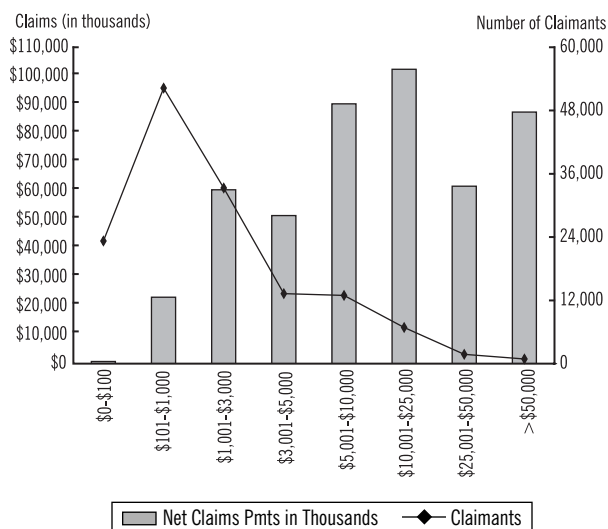
Includes all plan payments and patient payments for deductibles and copayments. (incurred data)

For 2004, payments for outpatient services represented 78 percent of the total — up from 62 percent in 1995. Outpatient payments grew at a rate of 24 percent per year between 1995 and 2004. Payments for inpatient services grew at almost 4.7 percent per year.



Paid Claims Distribution by Individual

About 7 percent of the plan members received benefits in excess of \$10,000 and accounted for 53 percent of the benefit payments. The average benefit for this group was \$26,399.



The State Employee Wellness Program was initiated in 1992. It is designed to improve awareness of the factors that can affect health and longevity, as well as to enable employees to take increased responsibility for their health by adopting healthier lifestyles. The program is funded, in part, through flexible benefits savings. The information on this page provides components and participation for the various programs offered by the State Employee Wellness Program.

Screenings

In 2004, 2,943 individuals attended a health screening.

Focused Intervention

Employees participating in screenings who were identified as having two or more high risks were invited to participate in the focused intervention or high-risk program. About 28 percent of the employees who qualified to participate in the intervention program (511 individuals) enrolled after the screenings. Each participant receives intervention telephone calls and follow-up calls by a health educator over the course of a year.

Toll-Free HealthLine

The HealthLine received 7,006 calls. Health educators answer this line and initiate calls to participants as well.

Seminar Series

During 2004, one new title was added to the seminar program: Fast Food Facts. A total of 532 employees participated in one or more of the seminars presented.

Working Well Newsletter

Working Well is an informative newsletter highlighting the State Employee Wellness and Employee Assistance Programs. The newsletter was published six times in 2004 and distributed via state payroll envelopes.

Babies First Prenatal Program

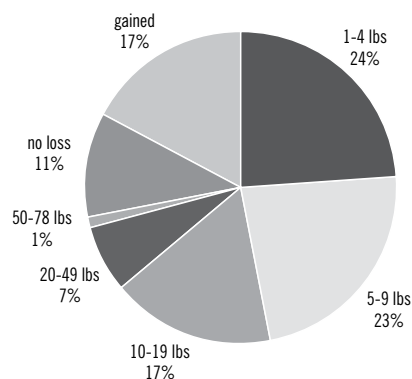
Designed to encourage early prenatal care, the program is open to female employees, spouses and dependents in the Preferred Provider Organization (PPO) or a Point of Service (POS) plan administered by BlueCross BlueShield. The program provides a \$50 credit or refund to the mother's deductible and copies of two books dealing with newborns. Participation in the program totaled 271 in 2004.

Fitness Center Discount Program

Over 100 fitness centers across the state provide membership discounts to participants in the state group insurance program.

Peel the Pounds Weight Loss Challenge

As a result of the six month weight loss program, a total of 9,517 or 4.75 tons were lost by 1,761 participants who completed the program — 71 percent of those who originally signed up to participate. Of those, 35 percent lost 5 percent of their total body weight and 13 percent lost 10 percent of their total body weight. The chart below details weight loss categories.



In 1985, the Tennessee General Assembly authorized creation of an insurance plan for local education employees. Funds were appropriated to pay part of the premiums for participating employees beginning January 1, 1986. School systems within the state may join the Local Education Plan or must provide alternative coverage that is equal or superior to the state-sponsored program.

At 2004 year end, 124 school systems and educational co-ops were participating in the Local Education Plan. Plan enrollment was 47,320 — up from 46,452 in 2003. The portion of plan members selecting the POS option continued to increase, growing from 14,277 to 16,328. PPO enrollment decreased from 27,015 to 25,702 while HMO selection increased from 5,160 to 5,290.

Dental insurance is available as an option to participants in the Local Education Plan. Participation in the dental plan increased from 4,514 in 2003 to 4,777 in 2004.

Life insurance and long-term care coverage are not available options to members in the self-insured Local Education Plan.

In 2004, there was a 9 percent increase in the total allowed amounts per capita for PPO members. The increase was attributable to both increasing outpatient and inpatient costs which were pushed mainly by increased price. For instance, the cost of hospitalization increased from \$2,524 to \$2,676 per day.

Total allowed amounts per capita by the POS option increased by 6.3 percent primarily due to increasing outpatient expenses. Total allowed amounts per capita by the HMO option increased by 7.9 percent when measured against 2003.

Pharmacy costs continue to impact the growth of benefit payments under the Local Education Plan. For the PPO option, the plan's cost for prescription drugs for each member increased from \$881 in 2003 to \$937 in 2004, representing an increase of 6.3 percent over one year. As a result of the increase in pharmacy, benefit modifications were made to plan options effective for the 2004 plan year. Early results indicate that the three-tier copay option, along with the implementation of a mail order benefit for pharmaceuticals, may have slowed the rate of increase in the overall cost of prescription drugs.

Health Contracts

Preferred Provider Organization (PPO)

BlueCross BlueShield	25,702
Percent of Total	54.3%

Health Maintenance Organization (HMO)

Aetna Nashville	523
Percent of Total	1.1%
Aetna Memphis	498
Percent of Total	1.1%
John Deere Health Knoxville	2,898
Percent of Total	6.1%
John Deere Health Chattanooga	564
Percent of Total	1.2%
John Deere Health Tri-Cities	807
Percent of Total	1.7%

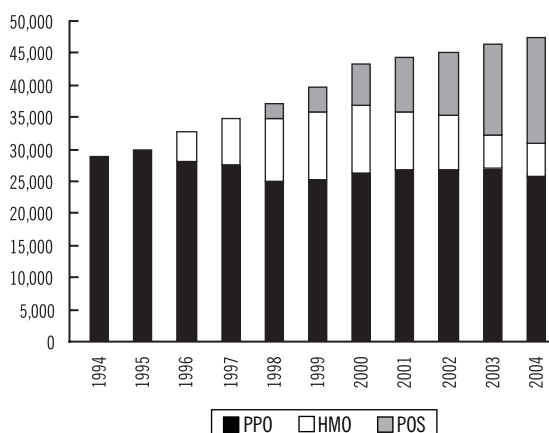
Point of Service (POS)

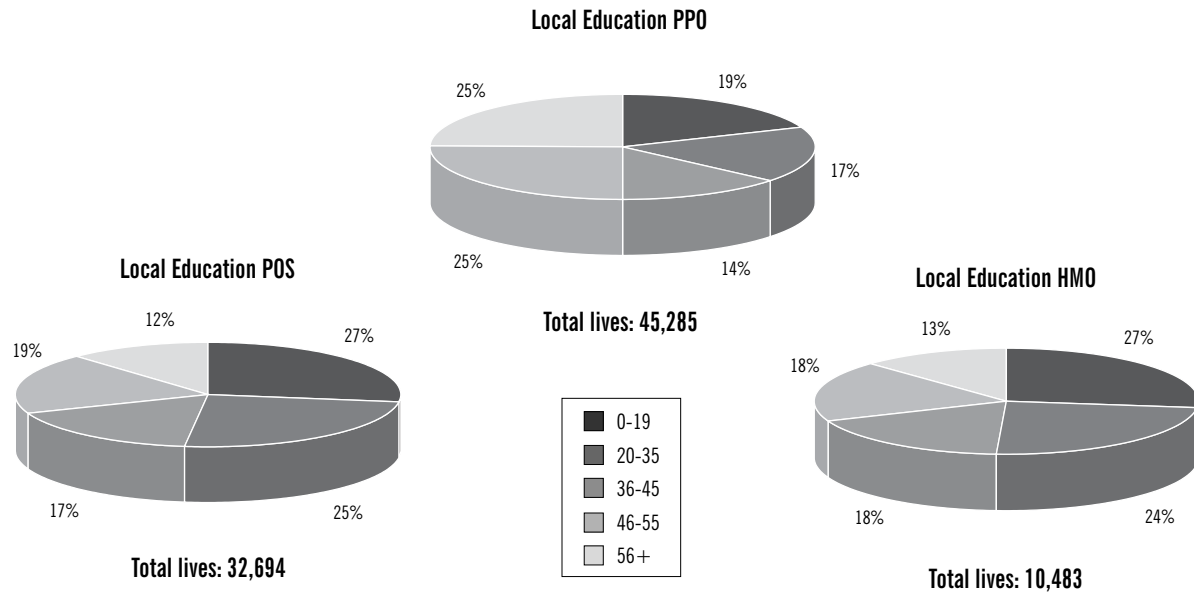
West — BlueCross BlueShield	2,574
Percent of Total	5.4%
Middle — BlueCross BlueShield	6,123
Percent of Total	12.9%
East — John Deere Health	7,631
Percent of Total	16.1%

Optional Insurance Contracts

	DEC. 31, 2004	DEC. 31, 2003
Dental Insurance		
Prepaid Plan	1,686	1,571
Preferred Provider Plan	3,091	2,943
Total Dental Insurance	4,777	4,514

Total Contracts by Healthcare Option



Health Enrollment Demographics**Chronic Conditions—Patients and Medical Costs**

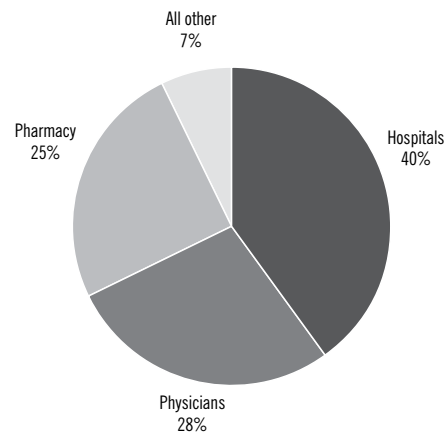
	TOTAL PATIENTS	TOTAL COSTS
Hypertension	13,283	\$ 1,947,849
Osteoarthritis	5,091	\$ 5,865,773
Diabetes	4,944	\$ 2,144,051
Mental Health—Depression	3,031	\$ 777,066
Coronary Artery Disease	2,460	\$ 9,009,965
Asthma	2,389	\$ 766,778
Mental Health—Anxiety Disorder	1,402	\$ 152,442
Obstructive Pulmonary Disease	1,034	\$ 671,689
Rheumatoid Arthritis	468	\$ 650,246
Mental Health—Bipolar Disorder	437	\$ 282,779
Congestive Heart Failure	412	\$ 851,651
HIV Infection	23	\$ 14,539

Medical costs represent the amount paid by the plan for facility and professional services provided under medical coverage (excluding prescription drugs). Data represents 2004 paid claims.

Benefits Distribution by Provider Type (Paid Claims)

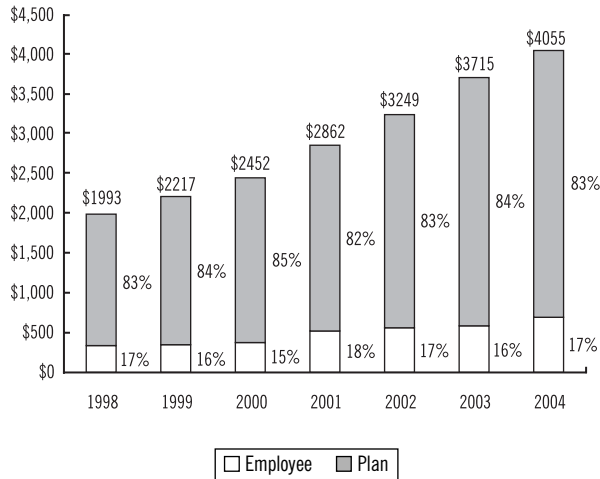
PPO, POS and HMO Total Disbursements: \$261,815,725 (amount reflects all health vendors submitting data for 2004)

Total self-insured paid claims for 2004 increased from \$245,380,977 in 2003. As a percent of the total, payments to hospitals and physicians increased when compared to 2003.



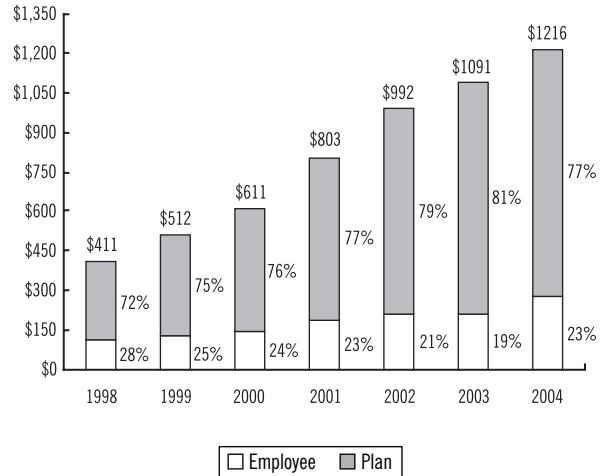
PPO Per Capita Payments

Employee portion represents deductibles and coinsurance/copays. Percentages indicate portion of medical expenses paid by employee or plan.



PPO Per Capita Drug Payments

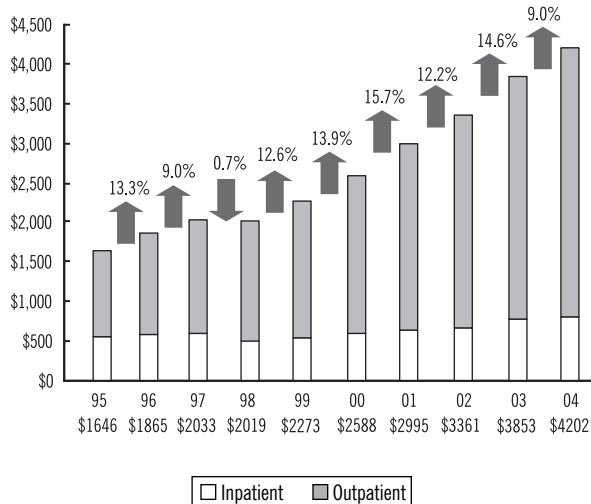
Percentages indicate portion of pharmacy expense paid by the employee and the plan.



PPO Total Payments Per Capita

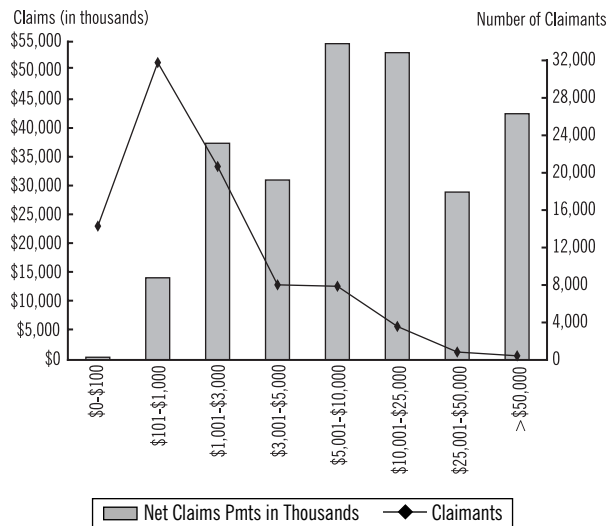
Includes all plan payments and patient payments for deductibles and copayments. (incurred data)

For 2004, payments for outpatient services increased to 81 percent of the total — up from 66 percent in 1995. Outpatient payments grew at a rate of 23.5 percent per year between 1995 and 2004. Inpatient grew at 4.9 percent per year during the same period.



Paid Claims Distribution by Individual

About 6 percent of the plan members received benefits in excess of \$10,000 and accounted for about 47 percent of the benefit payments. The average benefit for this group was \$25,650.



Participants

Alamo City Schools
 Alcoa City Schools
 Anderson County Schools
 Athens City Schools
 Bedford County Schools
 Bells City Schools
 Benton County Schools
 Bledsoe County Schools
 Bradford Special School District
 Bradley County Schools
 Bristol City Schools
 Campbell County Schools
 Cannon County Schools
 Carroll County Schools
 Carter County Schools
 Cheatham County Schools
 Chester County Schools
 Clay County Schools
 Cleveland City Schools
 Clinton City Schools
 Cocke County Schools
 Coffee County Schools
 Crockett County Schools
 Cumberland County Schools
 Dayton City Schools
 Decatur County Schools
 Dekalb County Schools
 Dyer County Schools
 Dyersburg City Schools
 Elizabethton City Schools
 Etowah City Schools
 Fayette County Schools
 Fayetteville City Schools

Fentress County Schools
 Franklin County Schools
 Franklin Special School District
 Gibson County Schools
 Giles County Schools
 Grainger County Schools
 Greene County Schools
 Greenville City Schools
 Grundy County Schools
 Hamblen County Schools
 Hancock County Schools
 Hardeman County Schools
 Hardin County Schools
 Hawkins County Schools
 Haywood County Schools
 Henderson County Schools
 Henry County Board of Education
 Hickman County Schools
 Hollow Rock – Bruceton Special School District
 Houston County Schools
 Humboldt City Schools
 Humphreys County Schools
 Huntingdon Special Schools
 Jackson County Schools
 Jefferson County Schools
 Kingsport City Schools
 Knox County Schools
 Lake County Schools
 Lauderdale County Schools
 Lawrence County Schools
 Lebanon – Tenth District Schools

Lenoir City Schools
 Lewis County Schools
 Lexington City Schools
 Lincoln County Schools
 Little TN Valley Education Co-op
 Loudon County Schools
 Macon County Schools
 Manchester City Schools
 Marion County Schools
 Marshall County Schools
 Maury County Schools
 McKenzie Special School District
 McMinn County Schools
 McNairy County School System
 Meigs County Schools
 Milan Special School District
 Monroe County Schools
 Moore County Schools
 Morgan County Schools
 Murfreesboro City Schools
 Newport City Schools
 Oak Ridge City Schools
 Obion County Schools
 Oneida Special School District
 Overton County Schools
 Paris Special School District
 Perry County Schools
 Pickett County Schools
 Polk County Schools
 Putnam County Schools
 Rhea County Schools

Richard City Special School District
 Roane County Schools
 Robertson County Schools
 Rogersville City Schools
 Scott County Schools
 Sequatchie County Schools
 Sevier County Schools
 Smith County Schools
 South Carroll County Special District
 Stewart County Schools
 Sullivan County Board of Education
 Sumner County Board of Education
 Sweetwater City Schools
 Tennessee Education Association
 Tipton County Schools
 Trenton Special School District
 Tri-County Vocational Schools
 Trousdale County Schools
 Tullahoma City Schools
 Unicoi County Schools
 Union City Schools
 Union County Schools
 Van Buren County Schools
 Warren County Schools
 Washington County Schools
 Wayne County Schools
 Weakley County Schools
 West Carroll Special School District
 White County Schools

In 1989, the Tennessee General Assembly authorized creation of an insurance plan for local government agency and quasi-governmental agency employees. At 2004 year end, 367 counties, cities and quasi-governmental agencies were participating in the Local Government Plan.

Plan enrollment was 15,568 at year end, a decrease from 16,415 in December 2003. Of the total enrollment, 5,397 participated in the PPO, while 4,305 were covered by HMOs. Enrollment in POSs totaled 5,686. The high deductible PPO Limited option established at the beginning of 2004 had a total enrollment of 180 at year end.

Dental insurance became available as an option to participants in the Local Government Plan in January 1993. Participation in the dental coverage at year end was 2,004.

Life insurance and long-term care coverage are not available options to members in the self-insured Local Government Plan.

In 2004, there was an 11.8 percent increase in the allowed amounts per capita for PPO members. The increase was attrib-

utable to increasing outpatient and inpatient costs, the latter of which was mainly affected by a decrease in utilization but an increase in cost. The increase in cost of hospitalization to \$3,001 per day also impacted inpatient benefit payments.

Total allowed amounts per capita by the POS option increased by 3 percent due to increases in both outpatient and inpatient expenses. The rise in outpatient expenses was attributable to both increasing utilization and the cost of each outpatient service. Total allowed amounts per capita by the HMO option increased by only 1.1 percent compared to the same measure in 2003.

Pharmacy costs continue to impact the growth of benefit payments under the Local Government Plan. For the PPO option, the plan's cost for prescription drugs increased from \$936 in 2003 to \$1,005 in 2004, representing an increase of 7.3 percent over one year. As a result of the increase in pharmacy, benefit modification were made to plan options effective for the 2004 plan year. Early results indicate that the three-tier copay option, along with the implementation of a mail order benefit for pharmaceuticals, may have slowed the rate of increase in the overall cost of prescription drugs.

Health Contracts

Preferred Provider Organization (PPO)

BlueCross BlueShield	5,397
Percent of Total	34.7%

Health Maintenance Organization (HMO)

Aetna Nashville	468
Percent of Total	3.0%
Aetna Memphis	758
Percent of Total	4.9%
John Deere Health Knoxville	2,124
Percent of Total	13.6%
John Deere Health Chattanooga	705
Percent of Total	4.5%
John Deere Health Tri-Cities	250
Percent of Total	1.6%

Point of Service (POS)

West — BlueCross BlueShield	1,458
Percent of Total	9.4%
Middle — BlueCross BlueShield	2,463
Percent of Total	15.8%
East — John Deere Health	1,765
Percent of Total	11.3%

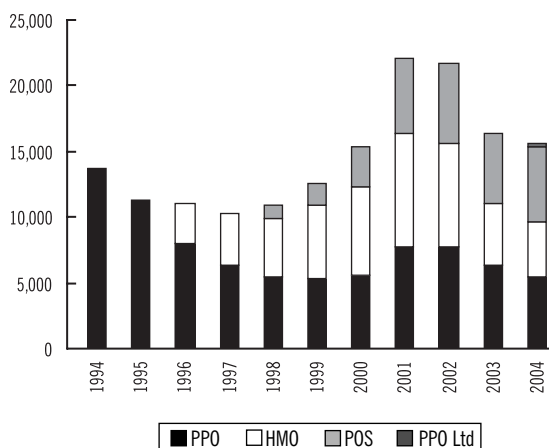
Preferred Provider Organization Limited (PPO Ltd)

BlueCross BlueShield	180
Percent of Total	1.2%

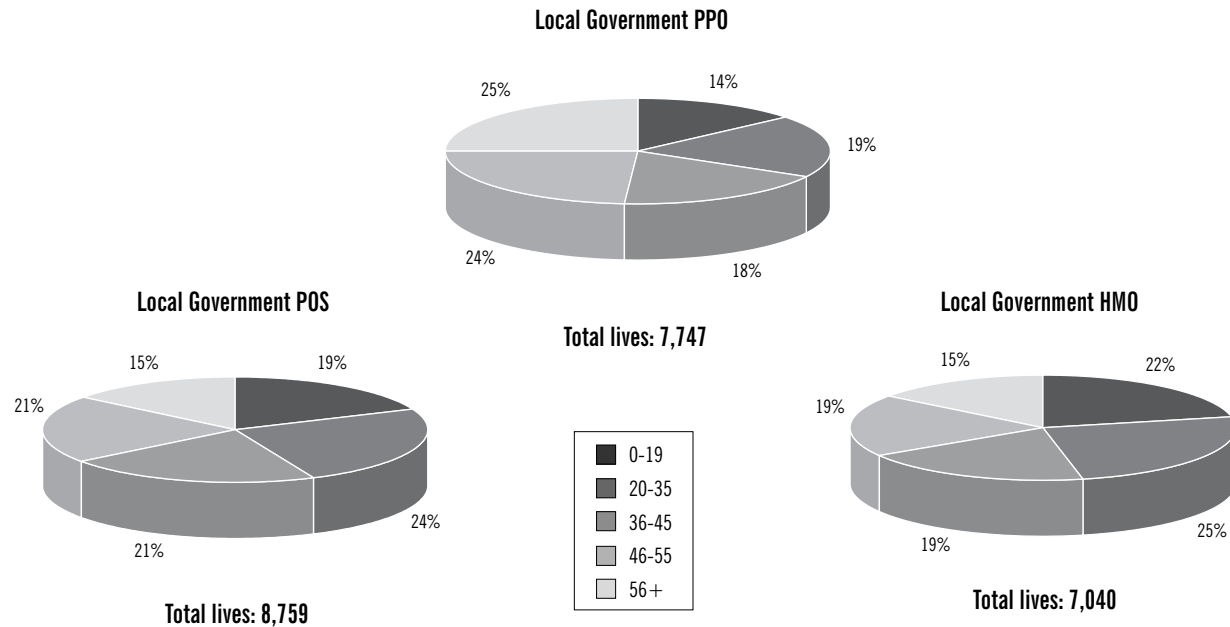
Optional Insurance Contracts

	DEC. 31, 2004	DEC. 31, 2003
Dental Insurance		
Prepaid Plan	1,141	1,269
Preferred Provider Plan	863	845
Total Dental Insurance	2,004	2,114

Total Contracts by Healthcare Option



Health Enrollment Demographics



Chronic Conditions—Patients and Medical Costs

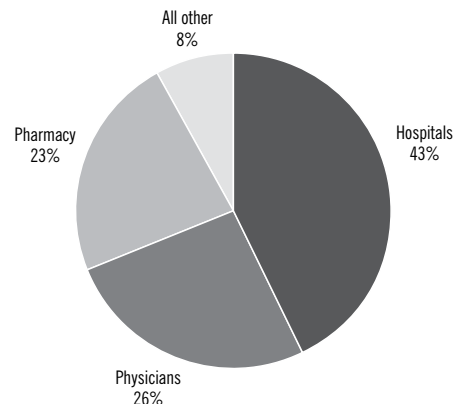
	TOTAL PATIENTS	TOTAL COSTS
Hypertension	4,586	\$ 748,922
Diabetes	1,976	\$ 764,191
Osteoarthritis	1,524	\$ 1,642,724
Coronary Artery Disease	1,060	\$ 4,830,672
Mental Health—Depression	1,003	\$ 252,419
Asthma	701	\$ 247,731
Obstructive Pulmonary Disease	580	\$ 472,454
Mental Health—Anxiety Disorder	512	\$ 51,119
Congestive Heart Failure	181	\$ 857,360
Mental Health—Bipolar Disorder	143	\$ 122,077
Rheumatoid Arthritis	142	\$ 187,939
HIV Infection	24	\$ 19,585

Medical costs represent the amount paid by the plan for facility and professional services provided under medical coverage (excluding prescription drugs). Data represents 2004 paid claims.

Benefits Distribution by Provider Type (Paid Claims)

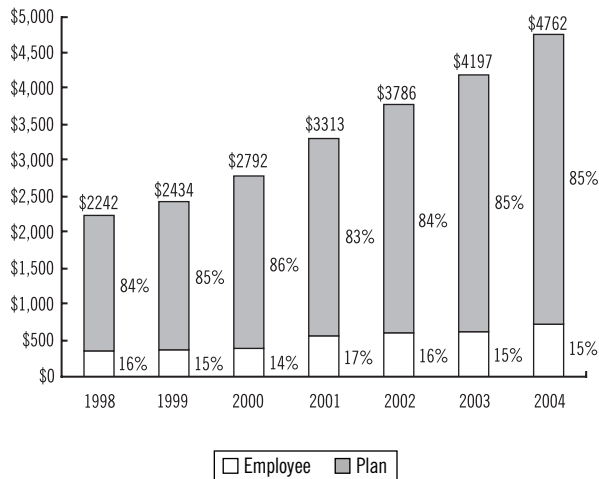
PPO, POS and HMO Total Disbursements: \$83,405,746 (amount reflects all health vendors submitting data for 2004)

Total self-insured paid claims for 2004 decreased from \$90,215,048 in 2003. This decrease is largely attributable to the decrease in the number of covered lives in the Local Government Plan. As a percent of the total, payments to physicians were basically flat when compared to 2003, while there was an increase in payments to hospitals.



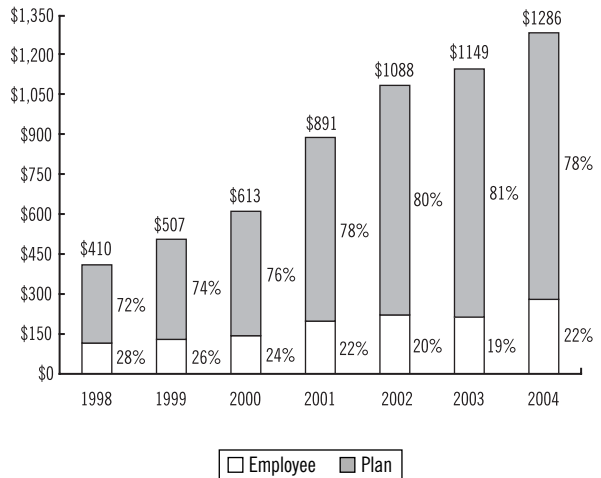
PPO Per Capita Payments

Employee portion represents deductibles and coinsurance/copays. Percentages indicate portion of medical expenses paid by employee or plan.



PPO Per Capita Drug Payments

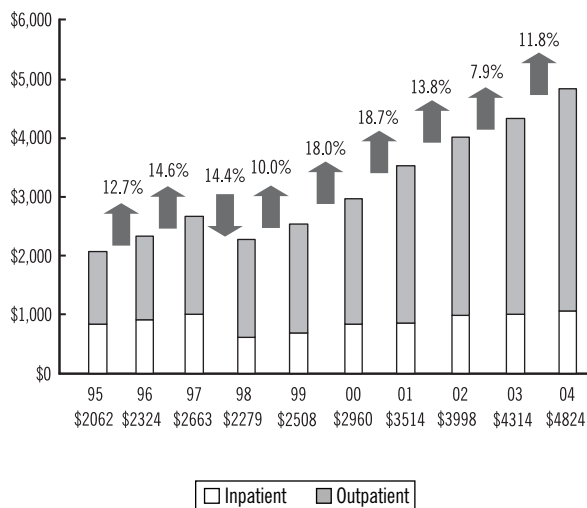
Percentages indicate portion of pharmacy expense paid by the employee and the plan.



PPO Total Payments Per Capita

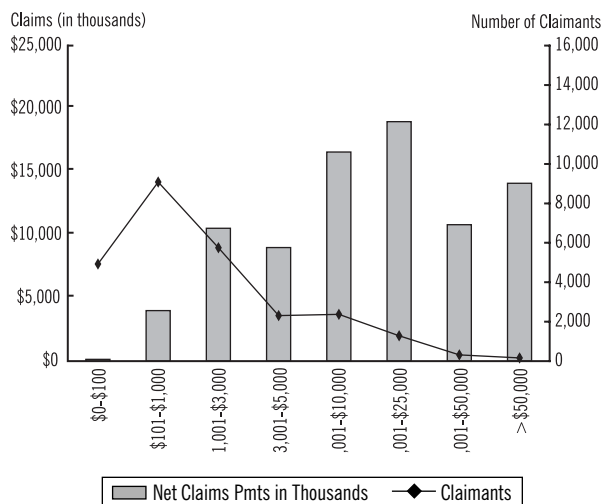
Includes all plan payments and patient payments for deductibles and copayments. (incurred data)

For 2004, payments for outpatient services increased to 78 percent of the total — up from 59 percent in 1995. Outpatient payments grew at a rate of 23 percent per year. Inpatient grew 2.9 percent per year during the same period.



Paid Claims Distribution by Individual

About 7 percent of the plan members received benefits in excess of \$10,000 and accounted for about 52 percent of benefit payments. The average benefit for this group was \$24,869.



Participants

Access Services of Middle TN
 Adult Community Training
 Aging Services of the Upper Cumberland
 Aid Distressed Families – Anderson County
 Alamo, City of
 Alcohol and Drug Council of Middle TN
 Alpha-Talbot Utility District
 Anderson County CAC
 Appalachian Education Community Corp.
 ARC of Hamilton County
 ARC of Washington County
 ARC of Williamson County
 Ashley's Place – Sumner Child Advocacy Center
 Atoka, Town of
 Atwood, Town of
 Battered Women, Inc.
 Bedford County
 Belle Meade, City of
 Bells, City of
 Benton County
 Better Decisions
 Big Creek Utility District
 Big Sandy, City of
 Bledsoe County
 Bloomingdale Utility
 Blount County CAA
 Blountville Utility
 Bon Aqua Lyles Utility
 Bondecroft Utility
 Bradley County
 Bradley/Cleveland CSA
 Bradley/Cleveland Services
 Bridge Refugee Services
 Bridges of Williamson County
 Bruceton, Town of
 Burns, City of
 Camden, City of
 Campbell County 911
 Care of Savannah, Inc.
 Carey Counseling Center
 Carroll County 911
 Carthage, Town of
 Caryville – Jacksboro Utility
 Caryville, Town of
 CASA – Juvenile Services
 CASA of the TN Heartland
 CASA, Inc.
 Castalian Springs – Bethpage Utility District

Catoosa Utility District
 CEASE, Inc.
 Celina, City of
 Center for Independent Living of Middle TN
 Centerville, Town of
 Chattanooga Boys Choir
 Chattanooga Endeavors, Inc.
 Cheatham County 911
 Cheatham County General
 Cheatham County Highway
 Children's Advocacy Center
 Children's Advocacy Center 9th Judicial District, Inc.
 Claiborne County Highway
 Clarksville Housing Authority
 Clarksville/Montgomery County CAA
 Clearfork Utility District
 Clifton, City of
 Clinchfield Senior Center
 Cocke County
 Cocke County 911
 Cocke County Highway
 Coffee County
 Collegedale, City of
 Collinwood, City of
 Community Development Center
 Community Network Services
 Coopertown, Town of
 Cornerstone
 County Wide Utility District
 Crab Orchard Utility District
 Crisis Intervention Center
 Crockett County
 Crockett County Highway
 Crockett Public Utility District
 Cross Plains, City of
 Cumberland Community Options, Inc.
 Cumberland County
 Cumberland Heights
 Cumberland Utility District
 Cunningham Utility District
 Dandridge, Town of
 Davidson County CSA
 Dayton, City of
 Decatur County
 Decaturville, Town of
 Decherd, City of
 Dekalb County
 DeWhite Utility
 Dover, Town of
 Dresden, City of
 East Ridge, City of

East TN CSA
 East TN Development District
 East TN Foundation
 Eastside Utility District
 Engstrom Services, Inc.
 Erin, City of
 Estill Springs, Town of
 Etheridge, City of
 Fairview, City of
 Fayette County
 Fayette County Public Works
 First TN Development District
 First Utility District of Tipton County
 First Utility of Hawkins County
 Forest Hill, City of
 Four Lake Regional Industrial Development Authority
 Franklin County
 Franklin County Adult Activity Center
 Franklin County Highway
 Franklin Consolidated Housing Authority
 Friendship, City of
 Gallatin Housing Authority
 Gallaway, City of
 Gibson County Municipal Water
 Gibson, City of
 Giles County
 Giles County 911
 Gladeville Utility District
 Gleason, City of
 Good Neighbor Mission and Crisis Center
 Goodwill Industries Knoxville, Inc.
 Gordonsville, Town of
 Greenbrier, City of
 Grundy County
 Grundy County Highway
 Grundy Emergency Medical Services
 Grundy Housing Authority
 Hamilton County 911
 Hamilton County CSA
 Hardeman – Fayette Utility District
 Hardin County Government
 Hardin County Skills, Inc.
 Harriman, City of
 Hartsville/Trousdale County
 Hawkins County
 Haywood County

Haywood County Highway
 Henderson, City of
 Henderson County
 Henderson County Highway
 Henry County Highway
 Hickman County
 Highland Rim Economic Corporation
 Hixson Utility District
 Homeplace, Inc.
 Homesafe of Sumner, Wilson and Robertson County
 Hope of East TN
 Humboldt Housing Authority
 Humboldt, City of
 Humphreys County
 Humphreys County 911
 Huntingdon, Town of
 Jackson Area Council on Alcohol and Drug Dependence
 Jackson Center for Independent Living
 James Developmental Center
 Jason Foundation
 Jasper, Town of
 Jefferson City Housing
 Jefferson County
 Jefferson County 911
 Johnson County
 Jubilee Community Arts
 Kids Place – A Child Advocacy Center
 Kimball, Town of
 Kings Daughters Day Home
 Kingsport Housing and Redevelopment Authority
 Kingston, City of
 Kingston Springs, Town of
 Knox County CSA
 Knoxville, City of
 Knoxville-Knox County CAC
 Lafayette, City of
 Lakeland, City of
 Lakesite, City of
 Lauderdale County
 Lawrence County
 Lawrence County 911
 Lawrence County Chamber of Commerce
 Lawrenceburg, City of
 Lawrenceburg Housing Authority
 Lexington, City of
 Lexington Electric System
 Linden, City of

Lobelville, City of	Northwest TN Economic Development Council	Sexual Assault Crisis CNT	TN School Board Association
Loretto, City of	Northwest TN Head Start	Sharon, City of	TN Secondary School Athletic Association
Lynnville, City of	Oak Ridge, City of	Shelby County 911	TN State Employees Association
Madison Suburban Utility	Oak Ridge Housing Authority	Shelby Residential and Vocational Services, Inc.	TN State Museum Foundation
Manchester Housing Authority	Old Hickory Utility	Shelter, Inc.	TN State Veterans Home – Humboldt
Marion County	Old Knoxville Highway Water District	Smith County	TN Veterans Home
Marion County Highway	Orange Grove Center	Smith County Highway	Tipton County
Marion County 911	Overton County	Smithville, City of	Tipton County 911 District
Marion Natural Gas	Parsons, City of	Smithville Electric System	Tiptonville, Town of
Mason, Town of	Partners in Placement	Soddy-Daisy Falling Water Utility	Troy, Town of
McKenzie, City of	Pathfinders, Inc.	South Carthage, Town of	Tullahoma Housing Authority
McMinn County	Pegram, Town of	South Central CSA	Tullahoma Utilities
McNairy County	Perry County Highway	South Central TN Development District	Twenty-first Drug Task Force
Development Services	Perry County Officials	South Central TN Workforce Board	Ujima House
Memphis and Shelby County CSA	Petersburg, Town of	South Pittsburg, City of	Unicoi, Town of
Memphis Center for Independent Living	Pleasant View, Town of	Southeast Mental Health Center	Union City Electric System
Mental Health Association of Middle TN	Portland, City of	Southeast Regional CHA	Union County EMS
Mid-Cumberland CAA	Powells Crossroad, Town of	Southwest CHA	Union County Highway
Mid-Cumberland CHA	Puryear, City of	Sparta Electric and Water System	United Cerebral Palsy Center
Mid-Cumberland HRA	Putnam County Rural Health Clinic	Spring City, Town of	Upper Cumberland CHA
Mid-East CAA	R & D Instructional Services	St. Joseph, City of	Upper Cumberland Development District
Midtown Mental Health Center	Rape and Sexual Abuse Center	Statewide Independent Living Council of TN	Upper East TN Human Resource Agency
Milan Public Utilities	Red Bank, City of	Stewart County	Urban Housing Solutions
Ministerial Association	Reelfoot Lake Regional Utility and Planning District	Stewart County Highway	Vital Center
Temporary Shelter	Rhea County	Sullivan County 911	Volunteer Memphis
Minor Hill Water Utility District	Rhea Medical Center	Sweetwater, City of	Walden, Town of
Monteagle, Town of	Riceville Utility District	Team Evaluation Center	Warren County
Mosheim, Town of	Ripley, City of	Temporary Residence for Adolescents and Crisis	Wartburg, City of
Mt. Carmel – Hawkins SCC	Ripley Gas/Water	TN Alcohol and Drug Association	Wartrace, Town of
Murfreesboro Electric Department	Roane Central Utility	TN Arts Center of Cannon County	WDVX Cumberland Communications
NAMI TN	Roane County	TN Association of County Executives	Weakley County
Nashville Cares	Roane County 911	TN Association of Utility Districts	Weakley County 911
Nashville Cares – Special Funding	Robertson County	TN Business Enterprises	Weakley County Municipal Electric System
National Association of Social Workers	Rochelle Center	TN Center for Nursing, Inc.	Webb Creek Utility
National Healthcare for the Homeless Council	Rose Center Council for the Arts	TN County Commissioners Association	West Overton Utility
New Directions	Rossville, Town of	TN County Highway Officials	West TN Legal Services, Inc.
New Horizons Corporation	Rutherford County Adult Action Center	TN County Services Association	West TN Special Technical Access Resource
New Johnsonville, City of	Savannah, City of	TN Healthcare Campaign	White Bluff, City of
New Market Utility District	Scott County	TN Historical Society	Whitehaven Southwest Mental Health Center
North Utility of Decatur/Benton County	Scotts Hill, Town of	TN Mental Health Consumers Association	Whitwell, City of
Northeast Community Services Agency	Second South Cheatham Utility District	TN Organization of School Superintendents	Williamson County Child Advocacy Center
Northeast Henry County Utility	Selmer, Town of		Winchester, City of
Northwest CHA	Senior Citizens, Inc.		Woodbury Housing Authority
Northwest Dyersburg Utility	Sequatchie County		Workforce Solutions
	Sequatchie Valley Planning		
	Serenity Recovery Center		
	Sertoma Center		
	Sevierville Water Department		

The EAP provides counseling and referral services for personal and workplace problems. Eligible employees and their dependents may receive up to six counseling sessions per problem episode at no direct cost. If more intensive treatment is needed, individuals may receive care through their insurance plan's mental health or substance abuse coverage. Training programs include employee orientations and supervisory training classes on the EAP services. Personal and professional growth seminars are held in nine locations across the state quarterly and upon request by agencies, departments and schools.

The program is available to all state and higher education employees/dependents who are eligible to participate in the State Group Insurance Program and all local education and local government employees who participate in a state-sponsored health plan.

United Behavioral Health reported 12,529 members accessing EAP services for the year, an increase from 10,970 in 2003. Of those, most were new cases. The overall EAP activity reached a high of 8.7 percent.

Participation in consultation and training services continues to be in high demand. Agencies, departments and schools contacted the EAP to provide assistance to staff units. A total of 670 hours were spent in training activities reaching around 9,000 employees. Supervisory training sessions are offered to teach supervisors how to use the EAP as one of their managerial tools in promoting good job performance. A total of 51 sessions were provided with attendance totaling 603.

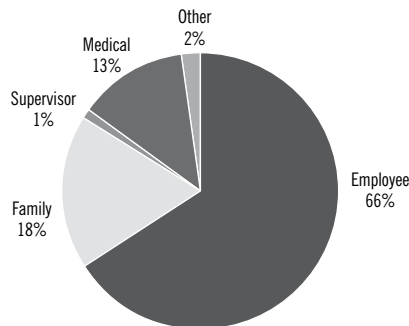
Employee Utilization

Counseling Services Utilization	5.5%
Training Utilization	6.1%

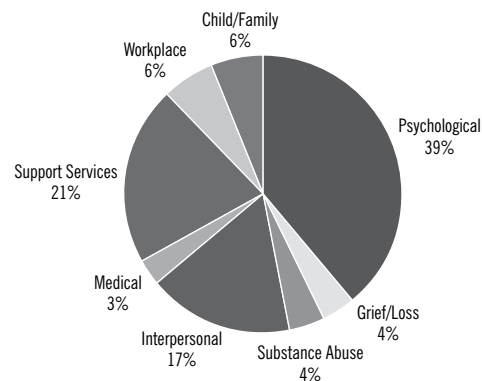
EAP Referral Utilization by Plan

State Plan	72%
Local Education Plan	20%
Local Government Plan	8%

Source of New Cases

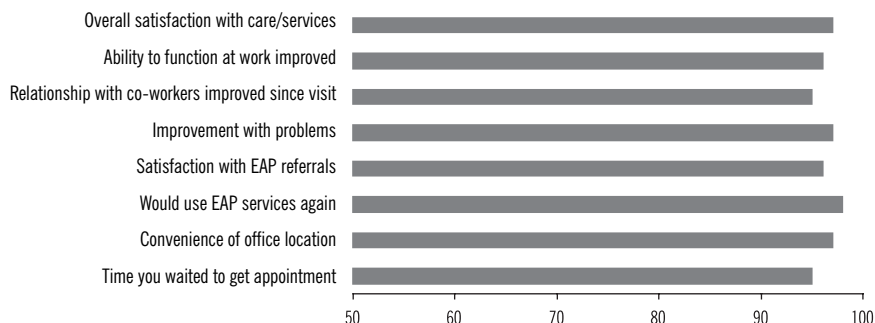


Problem Types of New Cases



EAP Client Office Session Questionnaire Responses

Total: 137



The management of mental health and substance abuse benefits through United Behavioral Health for the Integrated Employee Assistance and Behavioral Health program has continued to result in patients receiving care in more clinically appropriate and less costly settings.

As noted in the data, inpatient utilization, as reflected in admissions and days of care per 1,000 plan members decreased slightly from 2003 to 2004. Partial hospital rates and intensive outpatient rates increased slightly. However, through a combination of improved benefit design and improved clinical management, quality and access to appropriate levels of care continues to improve as well as maintaining appropriate cost.

**Outpatient Utilization — PPO and POS
Combined Plans**

	PATIENTS REVIEWED		SESSIONS PER 1,000*	
	2004	2003	2004	2003
Outpatient	10,767	10,929	198	252.9
Intensive Outpatient/ Partial Hospitalization	420	299	17.9	16.5

*per 1,000 covered individuals

**Inpatient Utilization — PPO and POS
Combined Plans**

	2004	2003
Number of Cases Reviewed	453	451
Admissions per 1000*	2.0	2.2
Days per 1,000*	12.4	12.6

*per 1,000 covered individuals

**Total Utilization and Cost Summary — PPO and POS
Combined Plans**

		AMOUNT PAID 2004
Outpatient	43,601	\$1,935,270
Intensive Outpatient/ Partial Hospitalization	3,962	718,693
Inpatient Days	2,747	1,366,270
		<u>\$4,020,233</u>

Since January 1989, the state has maintained a benefits program for Medicare-eligible, retired teachers and state employees. The program involves two elements: the sponsorship of Medicare supplement coverage and the provision of financial support for participating retirees.

Under the present structure, the Medicare Supplement Program offers three benefit options. Plans One and Two were changed at the beginning of 1998 to comply with standard plan requirements established by the National Association of Insurance Commissions (NAIC). Plan One matches the NAIC level D benefits. Plan Two offers level H benefits. Based upon action taken by the State Insurance Committee in September 2000, qualified retirees were offered the opportunity to select a third option. Plan Three provides benefits that supplement Medicare with the major portion of benefits being paid for prescription drugs. If Medicare benefits exceed Plan Three maximum payments, no benefits will be provided by Plan Three.

At year-end 2004, enrollment in Plan One was 5,667. Plan Two enrollment was 14,686. Enrollment in Plan Three was 2,380. Total enrollment increased only slightly compared to 2003.

The contract with BlueCross BlueShield for this coverage has contained a requirement that excess premiums be refunded to the state program on behalf of participating retirees. Half the excess premiums are returned at the end of the year; the balance at the end of the contract. Through the end of 2001, over \$27 million had been returned to the state under this contract requirement that was added at the beginning of 1992. These funds have resulted in reduced premiums for participating retirees through

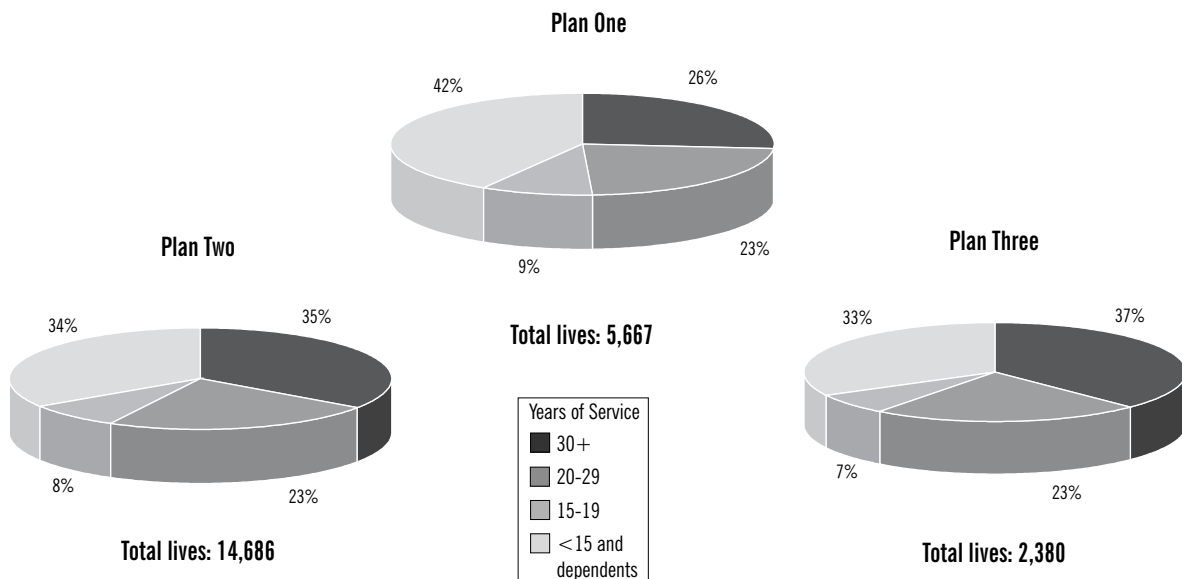
direct payment of part of the monthly retiree contribution. Beginning in 2001, the program changed to a self-insured plan with payment of an administrative fee to BlueCross to pay for claims processing and customer service. Funds previously returned to the state or resulting from the 2001 year operation have been obligated to establish reserves for incurred but unreported claims and for claims expense fluctuations. By making these changes, administrative expenses were lowered, premium taxes were avoided and premium levels were more closely matched to anticipated benefit payments.

For 2004, Plan One premium increased by 5 percent and Plan Two contributions increased by 4 percent. Plan Three premium, due to a substantial portion of benefits provided for rapidly rising pharmacy expenses, increased by 16 percent.

The state's financial support is based on a retiree's length of service. Retired teachers and state employees receive \$40 a month toward their premium if they have 30 or more years of service. For 20 to 29 years of service, they receive \$30 a month; for 15 to 19 years of service, they receive \$20 per month. The current support levels were set in July 1998.

This support is provided to Medicare Supplement Program participants and to retired teachers in school districts which sponsor employee medical plans and permit Medicare eligible retirees to continue coverage during retirement.

For 2004, financial support was provided to about 19,150 retirees each month, with an estimated annual cost of \$7.8 million.



The following unaudited financial statements for the State Plan, Local Education Plan, Local Government Plan and Medicare Supplement Program disclose the financial position and the results of operations for the year ended June 30, 2004. The Department of Finance and Administration, Division of Insurance Administration prepared these statements which summarize transactions for all coverages available through each plan. The

complete financial statements, accompanying notes and supplemental schedules are included in the Comprehensive Annual Financial Report (CAFR) for the State of Tennessee. The CAFR was prepared by the Department of Finance and Administration, Division of Accounts and was audited by the Comptroller of the Treasury, Division of State Audit.

State Plan — Comparative Statement of Net Assets

	30-JUN-04	30-JUN-03
Assets		
Cash	\$ 118,852,871	\$ 78,282,499
Insurance accounts receivable	1,078	3,071
Accounts receivable	2,113,866	3,058,309
Total assets	\$ 120,967,815	\$ 81,343,879
Liabilities		
Accrued liabilities	\$ 47,672,906	\$ 42,807,763
Accounts payable	842,836	748,303
Deferred revenue	30,672,144	28,389,672
Total liabilities	\$ 79,187,886	\$ 71,945,738
Net assets		
Unrestricted	\$ 41,779,929	\$ 9,398,141
Total net assets	\$ 41,779,929	\$ 9,398,141

State Plan — Comparative Statement of Revenues, Expenses and Changes in Net Assets

	30-JUN-04	30-JUN-03
Operating revenues		
Premiums	\$ 550,185,425	\$ 481,389,202
Other	60,966	171
Total operating revenues	\$ 550,246,391	\$ 481,389,373
Operating expenses		
Benefits/claims	\$ 479,045,302	\$ 416,419,720
Less: insurance recoveries	(9,788,639)	(10,424,348)
Administrative services	2,491,403	2,948,847
Contract services	39,699,400	36,590,374
Insurance premiums	7,851,651	8,474,616
Total operating expenses	\$ 519,299,117	\$ 454,009,209
Operating income	\$ 30,947,274	\$ 27,380,164
Non-operating revenues		
Interest income	\$ 951,868	\$ 745,818
Total non-operating revenues	\$ 951,868	\$ 745,818
Income before transfers	\$ 31,899,142	\$ 28,125,982
Transfers from flexible benefits fund	482,646	430,800
Change in net assets	\$ 32,381,788	\$ 28,556,782
Net assets, July 1	9,398,141	(19,158,641)
Net assets, June 30	\$ 41,779,929	\$ 9,398,141

State Plan — Comparative Statement of Cash Flows

	30-JUN-04	30-JUN-03
Cash flows from operating activities		
Receipts from interfund services provided	\$ 347,522,829	\$ 306,355,846
Receipts from customers and users	221,288,078	193,377,795
Payments to suppliers	(527,183,647)	(467,241,659)
Payments for interfund services used	(2,491,403)	(2,948,847)
Net cash from (used for) operating activities	\$ 39,135,857	\$ 29,543,135
Cash flows from noncapital financing activities		
Transfers in	\$ 482,646	\$ 430,800
Net cash from noncapital financing activities	\$ 482,646	\$ 430,800
Cash flows from investing activities		
Interest received	\$ 951,869	\$ 745,818
Net cash from investing activities	\$ 951,869	\$ 745,818
Net increase (decrease) in cash and cash equivalents	\$ 40,570,372	\$ 30,719,753
Cash and cash equivalents, July 1	78,282,499	47,562,746
Cash and cash equivalents, June 30	\$ 118,852,871	\$ 78,282,499
Reconciliation of operating income to net cash provided (used) by operating activities		
Operating income	\$ 30,947,274	\$ 27,380,164
Adjustments to reconcile operating income (loss) to net cash from operating activities		
(Increase) decrease in accounts receivable	\$ 946,436	\$ (1,035,401)
Increase (decrease) in accounts payable	4,959,675	(2,668,491)
Increase (decrease) in deferred revenue	2,282,472	5,866,863
Total adjustments	\$ 8,188,583	\$ 2,162,971
Net cash from (used for) operating activities	\$ 39,135,857	\$ 29,543,135

Local Education Plan — Comparative Statement of Net Assets

	30-JUN-04	30-JUN-03
Assets		
Cash	\$ 46,266,960	\$ 30,149,985
Insurance accounts receivable	1,260	1,428
Accounts receivable	1,442,628	1,962,378
Total assets	\$ 47,710,848	\$ 32,113,791
Liabilities		
Accrued liabilities	\$ 26,373,661	\$ 22,822,761
Accounts payable	5,074	—
Deferred revenue	1,244,204	990,694
Total liabilities	\$ 27,622,939	\$ 23,813,455
Net assets		
Unrestricted	\$ 20,087,909	\$ 8,300,336
Total net assets	\$ 20,087,909	\$ 8,330,336

Local Education Plan — Comparative Statement of Revenues, Expenses and Changes in Net Assets

	30-JUN-04	30-JUN-03
Operating revenues		
Premiums	\$ 287,449,058	\$ 249,837,768
Other	35,296	—
Total operating revenues	\$ 287,484,354	\$ 249,837,768
Operating expenses		
Benefits/claims	\$ 266,307,096	\$ 221,572,840
Less: insurance recoveries	(5,383,506)	(6,254,070)
Administrative services	1,164,712	1,319,950
Contract services	22,003,516	19,951,179
Total operating expenses	\$ 284,091,818	\$ 236,589,899
Operating income	\$ 3,392,536	\$ 13,247,869
Non-operating revenues		
Interest income	\$ 367,739	\$ 252,507
Total non-operating revenues	\$ 367,739	\$ 252,507
Income before transfers	\$ 3,760,275	\$ 13,500,376
Transfers from general fund	\$ 8,027,298	6,849,597
Change in net assets	\$ 11,787,573	\$ 20,349,973
Net assets, July 1	8,300,336	(12,049,637)
Net assets, June 30	\$ 20,087,909	\$ 8,300,336

Local Education Plan — Comparative Statement of Cash Flows

	30-JUN-04	30-JUN-03
Cash flows from operating activities		
Receipts from customers and users	\$ 289,530,898	\$ 249,698,968
Payments to suppliers	(280,644,249)	(237,599,101)
Payments for interfund services used	(1,164,712)	(1,319,950)
Net cash from (used for) operating activities	\$ 7,721,937	\$ 10,779,917
Cash flows from noncapital financing activities		
Transfers in	\$ 8,027,298	\$ 6,849,597
Net cash from noncapital financing activities	\$ 8,027,298	\$ 6,849,597
Cash flows from investing activities		
Interest received	\$ 367,740	\$ 252,507
Net cash from investing activities	\$ 367,740	\$ 252,507
Net increase (decrease) in cash and cash equivalents	\$ 16,116,975	\$ 17,882,021
Cash and cash equivalents, July 1	30,149,985	12,267,964
Cash and cash equivalents, June 30	\$ 46,266,960	\$ 30,149,985
Reconciliation of operating income to net cash provided (used) by operating activities		
Operating income	\$ 3,392,536	\$ 13,247,869
Adjustments to reconcile operating income (loss) to net cash from operating activities		
(Increase) decrease in accounts receivable	\$ 519,917	\$ (1,716,649)
Increase (decrease) in accounts payable	3,555,974	(1,119,803)
Increase (decrease) in deferred revenue	253,510	368,500
Total adjustments	\$ 4,329,401	\$ (2,467,952)
Net cash from (used for) operating activities	\$ 7,721,937	\$ 10,779,917

Local Education Plan — Required Supplementary Information

The table below illustrates how the Local Education Group Insurance Fund's earned revenues and investment income compare to related costs of loss and other expenses assumed by the Local Education Group Insurance Fund for each of the last ten years. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's earned contribution revenues and investment revenues. (2) This line shows each fiscal year's other operating costs of the fund including overhead and claims expense not allocable to individual claims. (3) This line shows the fund's incurred claims and allocated claim adjustment expenses (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year); some of these amounts are unavailable. (4) This section shows the cumulative amounts paid as of the end of successive years for each

policy year; some of these amounts are unavailable. (5) This section shows how each policy year's incurred claims increased or decreased as of the end of successive years; some of these amounts are unavailable. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known. (6) This line compares the latest reestimated incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature policy years. The columns of the table show data for successive fiscal and policy years.

Ten-Year Claims Development Information (expressed in thousands)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
(1) Required contribution and investment revenue earned (fiscal year)	79,410	83,340	95,185	109,968	123,419	126,918	166,476	203,669	250,090	287,814
(2) Unallocated expenses (fiscal year)	1,794	3,722	3,768	5,193	6,685	13,261	15,961	19,380	21,271	23,168
(3) Estimated claims and expenses, end of policy year, net incurred	*	*	*	*	*	141,005	185,219	210,650	248,618	*
(4) Net paid (cumulative) as of:										
End of policy year	*	*	*	*	*	124,084	162,993	189,585	223,756	*
One year later	*	*	*	*	*	139,458	182,699	211,337	*	
Two years later	*	*	*	*	*	139,349	182,569	*		
Three years later	*	*	*	*	*	139,340	*			
Four years later	*	*	*	*	*	*	*			
Five years later	*	*	*	*	*	*				
Six years later	*	*	*	*	*					
Seven years later	*	*	*	*	*					
Eight years later	*	*	*	*	*					
Nine years later	*	*	*	*	*					
(5) Reestimated net incurred claims and expenses:										
End of policy year	*	*	*	*	*	141,005	185,219	210,650	248,618	*
One year later	*	*	*	*	*	139,401	182,581	211,199	*	
Two years later	*	*	*	*	*	139,357	182,441	*		
Three years later	*	*	*	*	*	139,361	*			
Four years later	*	*	*	*	*	*	*			
Five years later	*	*	*	*	*	*				
Six years later	*	*	*	*	*					
Seven years later	*	*	*	*	*					
Eight years later	*	*	*	*	*					
Nine years later	*	*	*	*	*					
(6) Increase (decrease) in estimated net incurred claims and expenses from end of policy year	0	0	0	0	0	(1,644)	(2,778)	549	0	*

* Data Not Available

Local Government Plan — Comparative Statement of Net Assets

	30-JUN-04	30-JUN-03
Assets		
Cash	\$ 2,628,020	\$ —
Insurance accounts receivable	—	1,031
Accounts receivable	503,637	676,345
Total assets	\$ 3,131,657	\$ 677,376
Liabilities		
Accrued liabilities	\$ 8,780,577	\$ 11,027,297
Accounts payable	5,027	2,537,005
Deferred revenue	112,543	123,587
Total liabilities	\$ 8,898,147	\$ 13,687,889
Net assets		
Unrestricted (deficit)	\$ (5,766,490)	\$ (13,010,513)
Total net assets	\$ (5,766,490)	\$ (13,010,513)

Local Government Plan — Comparative Statement of Revenues, Expenses and Changes in Net Assets

	30-JUN-04	30-JUN-03
Operating revenues		
Premiums	\$ 98,283,102	\$ 101,205,959
Other	10,696	32
Insurance forfeitures	—	5,906
Total operating revenues	\$ 98,293,798	\$ 101,211,897
Operating expenses		
Benefits/claims	\$ 86,374,567	\$ 97,196,716
Less: insurance recoveries	(2,520,472)	(2,211,309)
Administrative services	503,205	577,934
Contract services	6,691,028	7,997,801
Total operating expenses	\$ 91,048,328	\$ 103,561,142
Operating income (loss)	\$ 7,245,470	\$ (2,349,245)
Non-operating revenues (expenses)		
Interest income (expense)	\$ (1,447)	\$ 13,224
Total non-operating revenues	\$ (1,447)	\$ 13,224
Change in net assets	\$ 7,244,023	\$ (2,336,021)
Net assets, July 1	(13,010,513)	(10,674,492)
Net assets, June 30	\$ (5,766,490)	\$ (13,010,513)

Local Government Plan — Comparative Statement of Cash Flows

	30-JUN-04	30-JUN-03
Cash flows from operating activities		
Receipts from customers and users	\$ 98,903,393	\$ 101,363,739
Payments to suppliers	(93,235,563)	(104,245,033)
Payments for interfund services used	(503,205)	(577,934)
Net cash from (used for) operating activities	\$ 5,164,625	\$ (3,459,228)
Cash flows from noncapital financing activities		
Negative cash balance implicitly financed	\$ (2,535,158)	\$ 2,535,158
Net cash from noncapital financing activities	\$ (2,535,158)	\$ 2,535,158
Cash flows from investing activities		
Interest received	\$ (1,447)	\$ 13,224
Net cash from investing activities	\$ (1,447)	\$ 13,224
Net increase (decrease) in cash and cash equivalents	\$ 2,628,020	\$ (910,846)
Cash and cash equivalents, July 1	—	910,846
Cash and cash equivalents, June 30	\$ 2,628,020	\$ —
Reconciliation of operating income to net cash provided (used) by operating activities		
Operating income (loss)	\$ 7,245,470	\$ (2,349,245)
Adjustments to reconcile operating income (loss) to net cash from operating activities		
(Increase) decrease in accounts receivable	\$ 173,740	\$ (360,220)
Increase (decrease) in accounts payable	(2,243,541)	(778,529)
Increase (decrease) in deferred revenue	(11,044)	28,766
Total adjustments	\$ (2,080,845)	\$ (1,109,983)
Net cash from (used for) operating activities	\$ 5,164,625	\$ (3,459,228)

Local Government Plan — Required Supplementary Information

The table below illustrates how the Local Government Group Insurance Fund's earned revenues and investment income compare to related costs of loss and other expenses assumed by the Local Government Group Insurance Fund for each of the last ten years. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's earned contribution revenues and investment revenues. (2) This line shows each fiscal year's other operating costs of the fund including overhead and claims expense not allocable to individual claims. (3) This line shows the fund's incurred claims and allocated claim adjustment expenses (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year); some of these amounts are unavailable. (4) This section shows the cumulative amounts paid as of the end of successive years for each

policy year; some of these amounts are unavailable. (5) This section shows how each policy year's incurred claims increased or decreased as of the end of successive years; some of these amounts are unavailable. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known. (6) This line compares the latest reestimated incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature policy years. The columns of the table show data for successive fiscal and policy years.

Ten-Year Claims Development Information (expressed in thousands)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
(1) Required contribution and investment revenue earned (fiscal year)	40,589	34,857	34,944	33,846	38,187	37,728	58,593	91,297	101,219	98,302
(2) Unallocated expenses (fiscal year)	852	1,425	1,184	1,335	1,732	4,251	6,315	9,396	8,576	7,194
(3) Estimated claims and expenses, end of policy year, net incurred	*	*	*	*	*	41,871	84,018	106,617	89,217	*
(4) Net paid (cumulative) as of:										
End of policy year	*	*	*	*	*	36,846	73,936	94,889	80,295	*
One year later	*	*	*	*	*	41,796	83,286	104,893	*	
Two years later	*	*	*	*	*	41,778	83,197	*		
Three years later	*	*	*	*	*	41,778	*			
Four years later	*	*	*	*	*	*	*			
Five years later	*	*	*	*	*	*				
Six years later	*	*	*	*						
Seven years later	*	*	*							
Eight years later	*	*								
Nine years later	*									
(5) Reestimated net incurred claims and expenses:										
End of policy year	*	*	*	*	*	41,871	84,018	106,617	89,217	*
One year later	*	*	*	*	*	41,782	83,241	104,826	*	
Two years later	*	*	*	*	*	41,778	83,184	*		
Three years later	*	*	*	*	*	41,758	*			
Four years later	*	*	*	*	*	*	*			
Five years later	*	*	*	*	*	*				
Six years later	*	*	*	*						
Seven years later	*	*	*							
Eight years later	*	*								
Nine years later	*									
(6) Increase (decrease) in estimated net incurred claims and expenses from end of policy year	0	0	0	0	0	(113)	(834)	(1,791)	0	*

* Data Not Available

Medicare Supplement Program— Comparative Statement of Net Assets

	30-JUN-04	30-JUN-03
Assets		
Cash	\$ 28,251,002	\$ 27,388,537
Accounts receivable	463,476	236,423
Total assets	\$ 28,714,478	\$ 27,624,960
Liabilities		
Accrued liabilities	\$ 5,341,658	\$ 5,532,797
Accounts payable	6,596	246
Deferred revenue	782,636	643,268
Total liabilities	\$ 6,130,890	\$ 6,176,311
Net assets		
Unrestricted	\$ 22,583,588	\$ 21,448,649
Total net assets	\$ 22,583,588	\$ 21,448,649

Medicare Supplement Program— Comparative Statement of Revenues, Expenses and Changes in Net Assets

	30-JUN-04	30-JUN-03
Operating revenues		
Premiums	\$ 36,804,508	\$ 34,340,139
Other	—	89
Total operating revenues	\$ 36,804,508	\$ 34,340,228
Operating expenses		
Benefits/claims	\$ 37,274,254	\$ 33,957,740
Less: insurance recoveries	(1,398,805)	—
Administrative services	298,731	303,223
Contract services	5,437,687	5,130,051
Total operating expenses	\$ 41,611,867	\$ 39,391,014
Operating income (loss)	\$ (4,807,359)	\$ (5,050,786)
Non-operating revenues		
Interest income	\$ 289,758	\$ 421,637
Total non-operating revenues	\$ 289,758	\$ 421,637
Income (loss) before transfers	\$ (4,517,601)	\$ (4,629,149)
Transfers from general fund	5,652,540	5,418,370
Change in net assets	\$ 1,134,939	\$ 789,221
Net assets, July 1	21,448,649	20,659,428
Net assets, June 30	\$ 22,583,588	\$ 21,448,649

Medicare Supplement Program — Comparative Statement of Cash Flows

	30-JUN-04	30-JUN-03
Cash flows from operating activities		
Receipts from customers and users	\$ 36,716,823	\$ 34,330,175
Payments to suppliers	(41,497,925)	(38,421,394)
Payments for interfund services used	(298,731)	(303,223)
Net cash from operating activities	\$ (5,079,833)	\$ (4,394,442)
Cash flows from noncapital financing activities		
Transfers in	\$ 5,652,540	\$ 5,418,370
Net cash from noncapital financing activities	\$ 5,652,540	\$ 5,418,370
Cash flows from investing activities		
Interest received	\$ 289,758	\$ 421,637
Net cash from investing activities	\$ 298,758	\$ 421,637
Net increase in cash and cash equivalents	\$ 862,465	\$ 1,445,565
Cash and cash equivalents, July 1	27,388,537	25,942,972
Cash and cash equivalents, June 30	\$ 28,251,002	\$ 27,388,537
Reconciliation of operating income to cash provided by operating activities		
Operating income (loss)	\$ (4,807,359)	\$ (5,050,786)
Adjustments to reconcile operating income to net cash from operating activities		
(Increase) decrease in accounts receivable	\$ (227,054)	\$ (236,423)
Increase (decrease) in accounts payable	(184,789)	666,397
Increase (decrease) in deferred revenue	139,369	226,370
Total adjustments	\$ (272,474)	\$ 656,344
Net cash from operating activities	\$ (5,079,833)	\$ (4,394,442)

Medicare Supplement Program — Required Supplementary Information

The table below illustrates how the Medicare Supplement Insurance Fund's earned revenues and investment income compare to related costs of loss and other expenses assumed by the Medicare Supplement Insurance Fund for the last ten years as previous year's information becomes available. As of June 30, 2004, only 42 months of data were available. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's or period's earned contribution revenues and investment revenues. (2) This line shows each fiscal year's or period's other operating costs of the fund including overhead and claims expense not allocable to individual claims. (3) This line shows the fund's incurred claims and allocated claim adjustment expenses (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year); some of these amounts are unavailable. (4) This section shows the cumula-

tive amounts paid as of the end of successive years for each policy year; some of these amounts are unavailable. (5) This section shows how each policy year's incurred claims increased or decreased as of the end of successive years; some of these amounts are unavailable. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known. (6) This line compares the latest reestimated incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature policy years. The columns of the table show data for successive fiscal and policy years.

Ten-Year Claims Development Information (expressed in thousands)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
(1) Required contribution and investment revenue earned (fiscal year)	—	—	—	—	—	—	20,145*	44,015	34,762	37,094
(2) Unallocated expenses (fiscal year)	—	—	—	—	—	—	2,375*	4,887	5,433	5,736
(3) Estimated claims and expenses, end of policy year, net incurred	—	—	—	—	—	—	28,163	32,387	36,105	**
(4) Net paid (cumulative) as of:										
End of policy year	—	—	—	—	—	—	23,657	27,205	31,050	**
One year later	—	—	—	—	—	—	28,536	31,875	**	
Two years later	—	—	—	—	—	—	28,662	**		
Three years later	—	—	—	—	—	—	**			
Four years later	—	—	—	—	—	—				
Five years later	—	—	—	—	—					
Six years later	—	—	—	—						
Seven years later	—	—	—							
Eight years later	—	—								
Nine years later	—									
(5) Reestimated net incurred claims and expenses:										
End of policy year	—	—	—	—	—	—	28,163	32,387	36,105	**
One year later	—	—	—	—	—	—	28,623	31,890	**	
Two years later	—	—	—	—	—	—	28,659	**		
Three years later	—	—	—	—	—	—	**			
Four years later	—	—	—	—	—	—				
Five years later	—	—	—	—	—					
Six years later	—	—	—	—						
Seven years later	—	—	—							
Eight years later	—	—								
Nine years later	—									
(6) Increase (decrease) in estimated net incurred claims and expenses from end of policy year	—	—	—	—	—	—	496	(497)	0	**

— Coverage was fully insured through December 2000

* Amounts only represent a 6-month fiscal period

** Data not available

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